Financial Markets

Irving Trust

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Economic Research &
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Friday (Noon) Aug. 21, 1981

Financial markets were highly nervous this week, attempting to divine the outcome of Tuesday's Federal Open Market Committee meeting. The best bet is that the Fed will continue its approach of very gradually easing pressure on bank reserves positions as--and if--prospects for a late-year surge in money growth recede.

On Thursday, the Fed announced a new credit facility primarily for thrift institutions, involving loans at rates as low as the basic discount rate. In part, this initiative is probably a sensible political response to the extreme weakness of thrift deposit flows. But a potentially more important aspect of the program is to provide a channel for supplementing the resources of the Federal Savings and Loan Insurance Corporation, so that there can be no question in the mind of the public concerning the adequacy of the reserves of the insurance funds. (Recall that, in 1974, the Fed loaned Franklin National Bank over $1 billion in order to provide similar assistance to the FDIC.) Most likely, the amount of advances under the new program will not be very large, as neither the Fed nor the Federal Home Loan Banks desire that the Fed assume the role of primary extender of adjustment credit to the thrift industry. Of course, such credit extensions as do occur will be offset easily through the Fed's open market operations, so there will be no impact on interest rates.

In the last three weeks, rates in the municipal bond market have increased sharply to all-time record levels, while rates on comparable maturity Treasury securities have been about unchanged on balance during the period. For example, the Bond Buyer index of 20 general obligation bonds soared 105 basis points to 12.49%, while the higher grade 11-bond index increased 100 basis points to 12.08%. The revenue bond index was up 92 basis points to 13.04%. These increases are traceable in large part to the spreading recognition of the implications of the Reagan tax program for the municipal securities market. Though the so-called "all-savers" provision has been the focus of attention, it will probably cause relatively few individuals to take funds out of the municipal securities market. More important is the reduction of individual income tax rates, cumulating to 23% in 1984 and subsequent years. Moreover, beginning in 1985 tax rates are indexed for changes in the Consumer Price Index, so that "bracket creep" will not cause individuals to support the municipals market as in the past. In addition, a little-noticed part of the legislation makes leasing significantly more attractive, enhancing the ability of banks to shelter income from tax. Since banks and individuals are the largest investors in the municipals market, the result is a double blow to the demand for municipal securities. As municipal financing pressures mount, this problem will likely prompt calls for Federal subsidization of certain municipal expenditures--unlikely in the present political climate. The Treasury would find more palatable a revived Taxable Bond Option, providing direct Treasury interest subsidies to issuers of taxable municipals. That would broaden the market--while transforming radically its present organization.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	8/21/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50%	20.50%	11.25%
Effective since	7/8/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	10.00
Federal Funds	17 50	17.50	10.13
Repurchase Agreements	17.00	17.25	9.50
U.S. Treasury Issues			
Bills			
3 months	16.20	16.18	10.02
6 months	16.90	16.96	10.70
1 year	16.60	16.63	11.02
Coupons			
2 years	16.20	16.07	11.10
4 years	15.72	15.48	11.25
7 years	15.18	14.95	11.30
10 years	14.86	14.65	11.26
Long Bond	14.09	13.85	11.21
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.00	18.10	10.30
3 months	17.95	18.05	10.75
6 months	18.10	18.05	11.00
1 year	17.35	17.50	11.50
Banker's Acceptances			
1 month	17.85	17.85	10.20
3 months	17.95	17.90	10.50
6 months	18.00	17.95	10.90
Eurodollar Deposits			
1 month	18.38	18.38	10.38
2 months	18.63	18.50	10.75
3 months	18.63	18.63	11.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.00	17.63	9.64
1 month	17.50	17.63	9.95
3 months	17.00	16.50	9.99
Bank Holding Companies			
1 month	17.25	17.50	9.45
Dealer Placed:			
3 months	17.25	17.63	10.25
New AA Corporate Utility Bond	17.00	16.85	12.75
Tax Exempt			
6 month Project Notes	8.50	8.35	6.40
1 year AAA Bond	9.30	8.40	5.90
5 year AAA Bond	10.00	8.90	6.20
20 year AAA Bond	12.00	11.00	8.20

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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